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SENSITIVE, SIPDIS

STATE FOR WHA/MEX, WHA/EPSC

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D FOR LOURDES CUE

DOE FOR A/S SANDALOW, G.WARD AND A.LOCKWOOD

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SUBJECT: CHICONTEPEC - WHO IS IN CHARGE OF MEXICAN HYDROCARBONS POLICY?

¶1. (SBU) SUMMARY: Juan Carlos Zepeda, head of Mexico's newly created National Hydrocarbons Commission (CNH), said that the press misquoted him last week as ordering PEMEX to stop drilling in Chicontepec. However, Zepeda is clearly unhappy with Pemex's current production policy in Chicontepec and will recommend to Secretary Kessel that the parastatal change its strategy dramatically given dismal results to date. Zepeda is outspoken and intent on influencing Pemex's exploration and production strategies. We expect to see more tension between Pemex and the CNH as Zepeda asserts himself over the coming months. END SUMMARY.

¶2. (SBU) ECONOFF met with Juan Carlos Zepeda October 15 to discuss recent press reports that he was ordering Pemex to halt production in Chicontepec given that production fell well below the parastatal's projections. The CNH was created under the energy reform legislation passed by the Mexican Congress in November 2008 to regulate the hydrocarbons sector and is responsible for conducting technical analysis and assessment of the country's hydrocarbons policy (including rates of extraction and rates of accruing reserves) and issuing regulations. CNH is tasked with submitting recommendations based on its studies to the Secretariat of Energy (SENER) who makes binding decisions on hydrocarbons policy for the government. Zepeda stressed that SENER, not PEMEX has legal responsibility for Mexico's hydrocarbons policy. He added that the Pemex is still digesting the fact that CNH has a role in production strategies, and some Pemex Exploration and Production (PEP) staff are still in shock that they no longer control these decisions.

¶3. (SBU) Zepeda said the press misquoted him on Chicontepec. However, he will make a recommendation to Secretary Kessel on Chicontepec before December 15. Zepeda noted that Pemex had not done sufficient geological advance work on the complex Chicontepec field. Chicontepec was discovered in the 1920s and is estimated to hold 40% of Mexican reserves. Pemex started exploiting the field in a limited manner in the 1970s, but held back due to the complex geology of the reservoir (faulting, ground pressure) and the high costs of production. According to Zepeda, Pemex panicked when production at Cantarell started to fall dramatically and the parastatal had no promising alternative source of production. Pemex estimated that Chicontepec could produce 90,000 barrels of oil equivalent (BOE) per day in 2009 and 600,000-700,000 BOE per day at its peak. Over the past 18 months, the parastatal made a significant investment and issued contracts worth approximately \$2 billion to service companies to exploit the field. Zepeda noted that in 2006, with 250 wells Chicontepec, production stood at 29,000 barrels a day. Today, with 1,000 wells the field's production is still around 29,000 barrels per day. The productivity of each individual well has fallen dramatically.

¶4. (SBU) Zepeda stressed that Pemex needs to take time to further

study the geology of the field and develop a better production plan.

He agreed that Mexico could not walk away from 40% of known reserves, but emphasized that the current policy is not workable. The CNH is responsible for making recommendations about the rate of extraction based on economic, technical and environmental standards, he added, and the current production plan does not meet CNH standards.

15. (SBU) Zepeda noted that the share prices of several service companies (he cited Weatherford) that operate in Chicantepec fell significantly in response to the comments he made last week. He implied that PEMEX' response to his comments were in part an effort by the parastatal to shore up the share prices of these firms.

16. (SBU) Zepeda currently has a skeleton staff of 20 employees, but needs near 100 qualified personnel to fulfill the CNH mandate. Zepeda blames the Finance Secretariat for not submitting a sufficient budget proposal for CNH to Congress and has been lobbying Diputados for more money. He will approach the World Bank and other organizations about a grant to build the Commission's database and is looking at other best practice models for the CNH. Embassy Mexico is working with SENER and CNH on a potential Voluntary Visitors Program which would provide CNH officials an opportunity to look at the US model.

17. (SBU) Comment: Zepeda is clearly pushing the envelope to test the CNH's authority over Pemex production strategies. The CNH has a mandate to advise the Secretary of Energy on hydrocarbons policy but has not been given the necessary budget to fully staff its operations. Some energy experts question whether Pemex and the Finance Ministry support CNH's efforts or are trying to undermine the CNH. Zepeda is outspoken and committed to making his mark. He

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served as Assistant Secretary for Exploration and Production in SENER before being named head of the CNH. With him at the helm, we expect to see more sparks fly between the CNH and PEMEX in coming months.

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